Frontera Resources Corporation and Subsidiaries

Condensed Consolidated Financial Statements
Three Months Ended March 31, 2008 and 2007

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Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Balance Sheets *(Unaudited)*

	March 31, 2008	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 6,528,586	$ 4,945,221
Restricted cash	10,058,668	15,118,786
Short-term investments	12,400,000	25,600,000
Accounts receivable	176,988	73,189
Inventory	10,620,866	9,293,005
Prepaid expenses and other current assets	1,498,603	1,268,503
Total current assets	41,283,711	56,298,704
Property and equipment, net	1,384,662	1,405,957
Oil and gas properties, full cost method		
Properties being depleted	23,750,981	23,750,981
Properties not subject to depletion	68,692,015	55,828,093
Less: Accumulated depletion	(21,547,846)	(21,457,846)
Net oil and gas properties	70,895,150	58,121,228
Other assets	2,283,383	2,431,254
Total assets	$ 115,846,906	$ 118,257,143
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 4,443,793	$ 3,049,928
Accrued liabilities	7,824,939	7,760,800
Total current liabilities	12,268,732	10,810,728
Convertible notes payable	70,184,812	68,572,500
Other long-term liabilities	36,994	38,595
Total liabilities	82,490,538	79,421,823
Commitments and contingencies		
Stockholders' equity		
Common stock	2,842	2,821
Additional paid-in capital	153,976,183	153,107,958
Common stock warrants	-	1,266
Treasury stock, at cost	(567,832)	(567,832)
Accumulated deficit	(119,854,825)	(113,708,893)
Accumulated other comprehensive loss	(200,000)	-
Total stockholders' equity	33,356,368	38,835,320
Total liabilities and stockholders' equity	$ 115,846,906	$ 118,257,143

The accompanying notes are an integral part of these condensed consolidated financial statements.

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statements of Operations *(Unaudited)*

	Three Months Ended March 31,	
	2008	2007
Revenue - crude oil sales	$ -	$ 1,308,171
Operating expenses		
Field operating and project costs	485,605	1,404,770
General and administrative	4,027,937	2,785,209
Depreciation, depletion and amortization	167,324	214,154
Total operating expenses	4,680,866	4,404,133
Loss from operations	(4,680,866)	(3,095,962)
Other income (expense)		
Interest income	380,755	339,608
Interest expense	(1,870,684)	(43,644)
Other, net	24,863	33,863
Total other income (expense)	(1,465,066)	329,827
Net loss	$(6,145,932)	$(2,766,135)
Loss per share		
Basic and diluted	$ (0.09)	$ (0.04)
Number of shares used in calculating loss per share		
Basic and diluted	70,629,142	70,383,528

The accompanying notes are an integral part of these condensed consolidated financial statements.

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statement of Stockholders' Equity *(Unaudited)*

	Common Stock	Additional Paid-in Capital	Common Stock Warrants	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balances at December 31, 2007	$ 2,821	$ 153,107,958	$ 1,266	$ (567,832)	$ (113,708,893)	$ -	$ 38,835,320
Conversion of convertible debt	3	110,497	-	-	-	-	110,500
Exercise of common stock warrants	15	1,251	(1,266)	-	-	-	-
Exercise of common stock options	3	78,997	-	-	-	-	79,000
Compensation expense-common stock option	-	677,480	-	-	-	-	677,480
Unrealized loss on short-term investments	-	-	-	-	-	(200,000)	(200,000)
Net loss	-	-	-	-	(6,145,932)	-	(6,145,932)
Total comprehensive loss for the year							(6,345,932)
Balances at March 31, 2008	$ 2,842	$ 153,976,183	$ -	$ (567,832)	$ (119,854,825)	$ (200,000)	$ 33,356,368

The accompanying notes are an integral part of these condensed consolidated financial statements.

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows *(Unaudited)*

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Cash flows from operating activities		
Net loss	$ (6,145,932)	$ (2,766,135)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation, depletion and amortization	167,324	214,154
Interest income–restricted cash	(58,668)	-
Debt issuance cost amortization	147,871	-
Noncash interest expense	1,722,812	-
Stock based compensation	677,480	508,066
Changes in operating assets and liabilities:		
Accounts receivable	(24,799)	(2,294)
Inventory	(1,327,861)	768,149
Prepaid expenses and other current assets	(230,100)	(914,232)
Accounts payable	1,393,865	(496,026)
Accrued liabilities	64,139	152,588
Other long-term liabilities	(1,601)	(744)
Net cash used in operating activities	(3,615,470)	(2,536,474)
Cash flows from investing activities		
Investment in oil and gas properties	(12,863,922)	(155,328)
Investment in property and equipment	(56,029)	(35,515)
Net redemption of other short-term investments	-	1,155,689
Redemption of auction rate securities	13,000,000	-
Net cash provided by investing activities	80,049	964,846
Cash flows from financing activities		
Repayments of borrowings	-	(51,097)
Restricted cash	5,118,786	-
Net cash provided by (used in) financing activities	5,118,786	(51,097)
Net increase (decrease) in cash and cash equivalents	1,583,365	(1,622,725)
Cash and cash equivalents		
Beginning of year	4,945,221	9,927,181
End of period	$ 6,528,586	$ 8,304,456
Supplemental disclosure of noncash investing and financing activities		
Exercise of common stock options	$ 79,000	$ -
Conversion of debt to common stock	110,500	-
Issuance of convertible notes in lieu of interest payments	1,722,812	-

The accompanying notes are an integral part of these condensed consolidated financial statements.

1. Nature of Operations

Frontera Resources Corporation, a Delaware corporation, and its subsidiaries (collectively "Frontera" or the "Company") are engaged in the development of oil and gas projects in emerging marketplaces. Frontera was founded in 1996 and is headquartered in Houston, Texas. The Company emphasizes development of reserves in known hydrocarbon-bearing basins, and is attracted to projects that have significant exploration upside. Since 2002, the Company has focused substantially all of its efforts on the exploration and development of oilfields within the Republic of Georgia ("Georgia"), a member of the Former Soviet Union.

In June 1997, the Company entered into a 25 year production sharing agreement with the Ministry of Fuel and Energy of Georgia and State Company Georgian Oil ("Georgian Oil"), which gives the Company the exclusive right to explore, develop and produce crude oil in a 5500 square kilometer area in eastern Georgia known as Block 12, hereafter referred to as the "Block 12 PSA". The Block 12 PSA can be extended if commercial production remains viable upon its expiration in June 2022.

Under the terms of the Block 12 PSA, the Company is entitled to conduct exploration and production activities and is entitled to recover its cumulative costs and expenses from the crude oil produced from Block 12. Following recovery of cumulative costs and expenses from Block 12 production, the remaining crude oil sales, referred to as Profit Oil, are allocated between Georgian Oil and Frontera in the proportion of 51% and 49%, respectively.

Under the terms of the Block 12 PSA, Frontera is exempt from all taxes imposed by the government of Georgia, and any taxes imposed on the Company shall be paid by Georgian Oil on behalf of the Company from Georgian Oil's 51% share of Profit Oil. Taxes are defined by the Block 12 PSA to mean all levies, duties, payments, fees, taxes or contributions payable to or imposed by any government agency, subdivision, municipal or local authorities within the Government of Georgia.

2. Basis of Presentation and Summary of Significant Accounting Policies

The condensed consolidated balance sheet of the Company at December 31, 2007 was derived from the Company's audited consolidated financial statements as of that date. The condensed consolidated balance sheet at March 31, 2008, the condensed consolidated statements of operations for the three month periods ended March 31, 2008 and 2007, the condensed consolidated statement of changes in stockholders' equity for the three month period ended March 31, 2008, and the condensed consolidated statements of cash flows for the three month periods ended March 31, 2008 and 2007 were prepared by the Company.

In the opinion of Company management, all adjustments, consisting of normal recurring adjustments, necessary to state fairly the consolidated financial position, results of operations and cash flows were recorded. The results of operations for the three month period ended March 31, 2008 are not necessarily indicative of the operating results for a full year or of future operations.

Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's consolidated financial statements for the year ended December 31, 2007.

For a description of the Company's accounting policies, refer to Note 2 of the 2007 consolidated financial statements.

Fair Value Measurements
Effective January 1, 2008, the Company implemented Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* for its financial assets and liabilities that are being measured on a recurring basis. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require new fair value measurements. SFAS No. 157 did not have an effect on the Company's financial statements other than requiring additional disclosures regarding fair value measurements. See Note 3.

Restricted Cash
At March 31, 2008 the Company had approximately $10.1 million of restricted cash. Restricted cash in the amount of $5.0 million serves as collateral for a $5.0 million line of credit that is used from time to time to support letters of credit that provide financial assurance that the Company will fulfill its obligations with respect to service contracts with certain vendors. The remaining $5.1 million is a portion of the proceeds from the convertible debt issuance in May 2007 of approximately $67.0 million, plus related earned interest, which is being held in escrow until the Company's stock price meets certain agreed benchmarks. Assuming no event of default has occurred, $5.1 million will be released from escrow after the stock price of the shares exceeds two times the conversion price for twenty consecutive trading days. See Note 6 for further discussion of the convertible notes terms. At December 31, 2007, the Company had restricted cash of approximately $15.1 million. In February 2008, $5.0 million of restricted cash related to the convertible debt was released from escrow after meeting the stock price benchmark.

Short-Term Investments
Short-term investments consist of Municipal Short Term Auction Rate Securities ("M-STARS") and corporate bonds both of which represent funds available for current operations. In accordance with the SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, these M-STARS are classified as available-for-sale and are carried at cost or par value, which approximates the fair market value. These securities have stated maturities beyond three months but are priced and traded as short-term instruments due to the liquidity provided through the interest rate mechanism of 7 to 35 days.

The auction process resets the applicable interest rates at prescribed calendar intervals and is intended to provide liquidity to the holders of auction rate securities by matching buyers and sellers in a market context, enabling the holders to gain immediate liquidity by selling such securities at par, or rolling over their investment. If there is an imbalance between buyers and sellers, there is a risk of a failed auction. Due to recent credit issues experienced by short-term funding markets, some of these securities, including our M-STARS, have failed at auction in 2008. An auction failure is not a default, and in some cases it could reset the applicable interest rates to a higher rate as outlined by the security. The Company does not currently intend to liquidate these investments at below par value or prior to a reset date. The Company will assess the fair value of these securities at the end of each quarter. Based on the Company's ability to access cash and cash equivalents, expected operating cash flows and other sources of cash, we do not anticipate that any lack of short-term liquidity related to these securities will materially affect the Company's ability to operate the business.

At March 31, 2008, short-term investments consist of investments in M-STARS with an estimated fair value of $12.4 million. At December 31, 2007, short-term investments consisted of investments in M-STARS with an estimated fair value of $25.6 million. See Note 3.

3. Fair Value Measurements

The Company implemented SFAS No. 157 effective January 1, 2008 for its financial assets and liabilities measured on a recurring basis. SFAS No. 157 applies to all financial assets and liabilities that are being measured and reported on a fair value basis. In February 2008, the FASB issued FSP 157-2, which delayed the effective date of SFAS No. 157 by one year for certain nonfinancial assets and liabilities.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The statement requires fair value measurements be classified and disclosed in one of the following categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company considers active markets as those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Measured based on prices or valuation models that required inputs that are both significant to the fair value measurement and less observable for objective sources (i.e., supported by little or no market activity).

As required by SFAS No. 157, financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels. Per SFAS No. 157, the Company has classified its short-term investments into one of the three levels based upon the data relied upon to determine the fair value.

Liquidity in certain auction rate securities markets was also significantly reduced in the first quarter of 2008, resulting in wide-spread auction failures and increasing rates for auction rate securities. Third-party pricing services are either no longer providing valuations for failed auction rate securities or are valuing such securities at par (which may not necessarily reflect prices that would be obtained in the secondary market for such securities if such a market were to develop). As a result, the Company assigned these securities to level 3 in the fair value hierarchy. In the absence of a secondary market, fair value was estimated based on a number of factors including the credit quality of the obligor, the credit quality of the bond insurer, the coupon, and the likelihood of refinancing by the issuer. Based on this analysis, a temporary impairment of $0.2 million was recorded to accumulated other comprehensive loss on the accompanying condensed consolidated balance sheet.

The following table summarizes the valuation of the Company's financial assets by SFAS No. 157 pricing levels as of March 31, 2008.

	Fair Value Measurement Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Asset at Fair Value
Short-term investments - M-STARS	$ -	$ -	$ 12,400,000	$ 12,400,000
	$ -	$ -	$ 12,400,000	$ 12,400,000

The table below sets forth a reconciliation for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the first quarter of 2008:

Short-term investments - M-STARS as of December 31, 2007	$ 25,600,000
Total gains or losses (realized/unrealized)	(200,000)
Purchases, issuances and settlements	(13,000,000)
Transfers in and out of Level 3	-
Short-term investments - M-STARS as of March 31, 2008	$ 12,400,000

4. Detail of Certain Balance Sheet Accounts

Inventory consists primarily of materials to be used in the Company's foreign oilfield operations and crude oil held in stock tanks. Inventory is valued using the first-in, first-out method and is stated at the lower of cost or market. Inventory consists of the following:

	March 31, 2008	December 31, 2007
Materials and supplies	$ 8,820,266	$ 7,997,192
Crude oil	1,800,600	1,295,813
	$ 10,620,866	$ 9,293,005

5. Notes Payable

Line of Credit

During 2007 the Company established a $5.0 million line of credit with a commercial bank by agreeing to collateralize $5.0 million of cash and cash equivalents. The line was primarily set up to support letters of credit issued by the Company from time to time in support of its oil and gas operations. The line of credit remains in place during 2008 and is being used in the same manner.

In February 2008, warrant holders exercised warrants to purchase 377,418 shares of common stock in a cashless exercise, pursuant to the warrant agreement. After this exercise no warrants remain outstanding.

6. Convertible Notes

During May 2007, the Company raised approximately $67.0 million through a private placement of convertible unsecured notes due May 2012. The notes were issued at par and bear interest at 10%, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes are convertible into shares of common stock at conversion price of $1.67 per share. The conversion price will be reset to $1.30 per share if the stock price is at or below $1.30 per share for 10 out of any 20 consecutive trading days at any time in the 12 months following the closing date. The notes will be automatically converted into common stock at the conversion price if the stock price exceeds two times the conversion price for at least 20 consecutive trading days. As part of the closing of the notes, debt issuance costs of approximately $2.7 million were incurred, of which approximately $1.5 million was paid in cash and $1.2 million of additional convertible notes and stock options were issued for the remainder.

During June 2007, note holders holding $100,000 of convertible notes elected to convert their notes into 59,880 shares of common stock.

During January 2008, note holders holding $110,500 of convertible notes elected to convert their notes into 65,906 shares of common stock.

At December 31, 2007 and March 31, 2008 the Company elected to pay their quarterly interest payments in kind and issued $1,672,500 and $1,722,812, respectively, in additional convertible notes in accordance with terms of the note purchase agreement.

7. Income Taxes

The Company has incurred losses since inception and, therefore, has not been required to pay federal income taxes. In accordance with applicable generally accepted accounting principles, the Company estimates for each interim reporting period the effective tax rate expected for the full fiscal year and uses that estimated rate in providing income taxes on a current year to date basis. The Company has established a valuation allowance that is primarily attributable to U.S. federal deferred tax assets. Management believes enough uncertainty exists regarding the realization of the deferred items and has recorded a full valuation allowance.

For the three months ended March 31, 2008 and 2007, no income tax payments were made.

8. Commitments and Contingencies

SOCAR Arbitration

In June 1998, Frontera Resources Azerbaijan Corporation, an indirect wholly owned subsidiary of the Company, entered into a production sharing agreement with the State Oil Company of the Azerbaijan Republic (SOCAR), hereafter referred to as the "Azerbaijan PSA". The Azerbaijan PSA covered the Kursangi and Karabagli onshore oilfields in an area of Azerbaijan known as the "K&K Block". The Company and an operating partner undertook an exploration and development program on the K&K Block. The Company's relationship with SOCAR deteriorated as a result of several disputes under the Azerbaijan PSA and the Company was unsuccessful at reaching a settlement with SOCAR.

Frontera initiated binding arbitration against SOCAR in October 2003 related to claims resulting from SOCAR's halting of oil exports from the K&K Block during the fourth quarter of 2000. The arbitration was held in Stockholm under the rules of the United Nations Commission on International Trade Law. In January 2006, the arbitral panel found that the halting of exports of

crude oil from the K&K Block was in violation of the Azerbaijan PSA and awarded Frontera approximately $1.2 million plus interest from 2000 until payment is made. The arbitral panel rejected all other claims and counterclaims between the parties.

SOCAR has refused to pay the award and filed an action in the Svea Court of Appeals in Stockholm to annul the award. The Company moved to dismiss on procedural grounds, and the court ruled in the Company's favor on a majority of the counts. The proceedings are continuing before the appeals court and final disposition is expected in 2008. As a result of SOCAR's refusal to pay the award, the Company commenced an action in the United States District Court for the Southern District of New York in February 2006, seeking to enforce the award. In March 2007, the District Court granted SOCAR's motion to dismiss, and the Company appealed that decision in July 2007 to the United States Court of Appeals for the Second Circuit. The hearing on the appeal is expected to occur in the second quarter of 2008.

GAC Arbitration

In June 2007, Frontera Resources Georgia Corporation, an indirect wholly owned subsidiary of the Company ("FRGC"), was served a notice of arbitration and claim by GAC Energy Company and an affiliated company (collectively, "GAC"). GAC and Frontera were parties to a Farmout Agreement dated June 2002 covering Block 12 (the "Farmout Agreement"), pursuant to which GAC would earn a 25% working interest in Block 12 and a 12.5% interest in Frontera Eastern Georgia Limited, an indirect consolidated subsidiary of the Company ("FEGL"), upon the fulfillment of certain financial and work program commitments. In September 2004, as required under the terms of the Farmout Agreement, GAC reassigned its interest in Block 12 to Frontera as a result of GAC's default on its financial and work program commitments. The notice of arbitration and claim alleges that GAC did not default on its obligations under the Farmout Agreement and should be awarded a 25% working interest in Block 12, a 12.5% ownership interest in FEGL and a proportionate share of the revenue from oil sales from July 2002 to August 2003. In August 2007, Frontera filed its statement of defense and counterclaims against GAC, and in October 2007, Frontera initiated arbitration against certain third parties involved with GAC alleging that they fraudulently induced Frontera to enter into the Farmout Agreement with GAC. The evidentiary hearing in the GAC arbitration has been scheduled for July 2008. Frontera considers the GAC claim to be without merit and intends to vigorously defend itself against this claim.

ARAR Arbitration

In January 2008, FEGL, served a notice of arbitration and claim on ARAR, Inc. ("ARAR"), for breach of contract under a drilling services contract dated May 2007, specifically for, among other things, failure to commence work by the time specified in the contract, failure of the drilling rig to meet required specifications and failure to reconcile advance payments made by FEGL with work actually performed. FEGL terminated the contract after ARAR failed to mobilize the rig to the required location and failed to commence work as otherwise required under the contract. FEGL seeks damages in excess of US $2.0 million in the arbitration. ARAR denies FEGL's claims and has filed counterclaims against FEGL, seeking payments in excess of $3.0 million for, among other things, standby charges for the period of time the rig was undergoing inspection and repairs to bring it into contract specification, early termination fees and demobilization fees. Frontera considers the ARAR counterclaims to be without merit and intends to vigorously defend itself. The arbitration panel has not yet been confirmed, and therefore no timeline for the arbitration has been established.

9. Stockholders' Equity

Preferred Stock

The Company has the authority to issue up to 10,000,000 shares, par value $.00001, of serial preferred stock. No preferred stock was outstanding at March 31, 2008 and December 31, 2007. The Board of Directors may designate and authorize the issuance of such shares with such voting power and in such classes and series, and with such designation, preferences and relative participation, optional, or other special rights, qualifications, limitations, or restrictions as deemed appropriate by the Company's Board of Directors.

Common Stock

As of March 31, 2008 and December 31, 2007 the Company was authorized to issue 200,000,000 shares of common stock, par value $.00004 per share. As of March 31, 2008 and December 31, 2007, the Company had 70,989,732 and 70,463,408, respectively, of common shares issued and outstanding. At March 31, 2008 and December 31, 2007, there were an additional 12,916,800 and 15,061,000 shares, respectively, of common stock reserved for the exercise of existing options and warrants.

Treasury Stock

At March 31, 2008 and December 31, 2007, the Company had 5,739,855 shares of treasury stock, all held as common shares.

For the three months ended March 31, the Company recognized stock-based compensation expense related to common stock options of approximately $0.7 million in 2008 and $0.5 million in 2007. Stock-based compensation expense is reflected in general and administrative expense in the condensed consolidated statements of operations.

Introduction

The following discussion and analysis should be read in conjunction with the accompanying financial statements and related notes thereto. The following discussion contains forward-looking statements that reflect our future plans, estimates, beliefs and expected performance. The forward-looking statements are dependent upon events, risks and uncertainties that may be outside our control. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, market prices for natural gas and oil, economic and competitive conditions, regulatory changes, estimates of proved reserves, potential failure to achieve production from development projects, capital expenditures and other uncertainties, as well as those factors discussed below, particularly in "Risk Factors" and "Cautionary Statement Concerning Forward-Looking Statements," all of which are difficult to predict. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may not occur.

The financial information with respect to the three month periods ended March 31, 2008 and 2007 that is discussed below is unaudited. In the opinion of management, this information contains all adjustments, consisting only of normal recurring accruals, necessary for the fair presentation of the results for such periods. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full fiscal year.

Overview of Our Company

Frontera Resources Corporation, a Delaware corporation, and its subsidiaries (collectively "Frontera" or the "Company") are engaged in the development of oil and gas projects in emerging marketplaces. Frontera was founded in 1996 and is headquartered in Houston, Texas. The Company emphasizes development of reserves in known hydrocarbon-bearing basins, and is attracted to projects that have significant exploration upside. Since 2002, the Company has focused substantially all of its efforts on the exploration and development of oilfields within the Republic of Georgia ("Georgia"), a member of the Former Soviet Union. Prior to 2002, the Company's other significant operating focus was on the exploration and development of an oilfield within the Azerbaijan Republic ("Azerbaijan"), which was sold during 2002 and all operating activities in Azerbaijan ceased at that time.

In accordance with full cost accounting rules, we are subject to a limitation on capitalized costs. The capitalized cost of natural gas and oil properties, net of accumulated depreciation, depletion and amortization, may not exceed the estimated future net cash flows from proved oil and gas reserves discounted at 10%, plus the lower of cost or fair market value of unproved properties as adjusted for related tax effects, which is known as the ceiling limitation. If capitalized costs exceed the ceiling limitation, the excess must be charged to expense. We did not have any adjustment to earnings due to the ceiling limitation for the periods presented herein.

Results of Operations
Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007

Revenue. There were no revenues for the three months ended March 31, 2008 compared to $1.3 million for the three months ended March 31, 2007. The Q1 2008 production is expected to be sold in Q2 2008. The Q1 2007 revenue was mainly attributable to production from the latter two quarters of 2006.

Operating Costs and Expenses. Total operating costs and expenses increased to $4.7 million for the three months ended March 31, 2008 compared to $4.4 million for the same period in 2007.

Field operating and project costs includes the costs associated with our exploration and production activities, including, but not limited to, drilling, field operating expense and processing costs.

Field operating and project costs decreased $0.9 million to $0.5 million during the three months ended March 31, 2008 as compared to $1.4 million for the three months ended March 31, 2007 primarily due to the cost of oil produced in late 2006 and early 2007 associated with the company's Q1 2007 oil and gas sale. In Q1 2008 there was no sale and accordingly the cost of oil produced was charged to the oil inventory account rather than field operating costs.

DD&A decreased $47 thousand during the three months ended March 31, 2008 as compared to the three months ended March 31, 2007 primarily due to lower depletion expense associated with lower production volumes in 2008, and our oil processing facility becoming fully depreciated during 2007.

General and administrative expenses increased $1.2 million to $4.0 million for the three months ended March 31, 2008 from $2.8 million for the comparable period in 2007. The increase was attributable to an increase in compensation expense of $0.5 million of which $0.2 million related to a non-cash charge for stock option compensation expense under the provisions of SFAS 123R. The remaining $0.3 million increase related to costs associated with staffing up for increased operations which were not completed until the latter part of 2007. Legal expenses increased $0.4 million as the Company ramped up preparations for two arbitration hearings and travel was up $0.1 million as the Company's exploration, production, and financing activities increased in 2008 as compared to 2007.

Other Income (Expense). Total other expense increased to $1.5 million in the three month period ended March 31, 2008 from other income of $0.3 million in the three month period ended March 31, 2007. The $1.8 million increase in expense is primarily attributable to an increase in interest expense of $1.8 million.

Interest income was $0.4 million for the three months ended March 31, 2008 and $0.3 million for the three months ended March 31, 2007 as cash available for investment was about the same.

Interest expense increased to $1.8 million for the three months ended March 31, 2008 from $0.05 million for the same period in 2006. This increase was attributable to increased average debt balances in the 2008 period attributable to the Company's $67.0 million convertible debt offering during Q2 of 2007.

Liquidity and Capital Resources

Summary

Our operating cash flow is influenced mainly by the prices that we receive for our oil production; the quantity of oil we produce; and the success of our development and exploration activities. Currently we do not generate sufficient operating cash flows to cover our general corporate activities or our planned capital expenditure programs.

As of March 31, 2008, our cash and cash equivalents were $6.5 million, our short-term investments were $12.4 million and we had approximately $10.1 million of restricted cash. Up to $5.0 million of the restricted cash will be released if the Company's stock price exceeds $3.34 for twenty consecutive trading days. At March 31, 2008, the Company's stock was trading at $2.29. The remaining $5.0 million serves as collateral for a $5.0 million line of credit that is used from time to time to support letters of credit that provide financial assurance that the Company will fulfill its obligations with respect to service contracts with certain vendors. See Notes 2, 5 and 6 of the attached financial statements for further discussion of the convertible notes, the line of credit and the restricted cash. At March 31, 2008 the Company had $70.2 million of convertible long term debt outstanding. The Company had no other outstanding debt at March 31, 2008.

Liquidity in certain auction rate securities markets was also significantly reduced in the first quarter of 2008, resulting in wide-spread auction failures, including our M-STARS, and increasing rates for auction rate securities. Third-party pricing services are either no longer providing valuations for failed auction rate securities or are valuing such securities at par (which may not necessarily reflect prices that would be obtained in the secondary market for such securities if such a market were to develop). As a result, the Company assigned these securities to level 3 in the fair value hierarchy. In the absence of a secondary market, fair value was estimated based on a number of factors including the credit quality of the obligor, the credit quality of the bond insurer, the coupon, and the likelihood of refinancing by the issuer. Based on this analysis, a temporary impairment of $0.2 million was recorded to accumulated other comprehensive loss on the accompanying condensed consolidated balance sheet.

Capital Expenditures

We make and expect to continue to make substantial capital expenditures in the exploration, development, and production of natural gas and oil reserves. We believe that our cash flows from operations, current cash and investments on hand will be sufficient to meet the non-discretionary portion of our capital expenditure budget for the next twelve months.

We estimate that our total capital expenditures for 2008 will be approximately $51.6 million, of which $13.0 million had been spent/committed as of March 31, 2008. Our planned 2008 capital expenditures represent a 76% increase over actual capital expenditures in 2007. Substantially all of our capital expenditure budget for the remainder of the year is discretionary and will be contingent on raising additional capital on terms that are satisfactory to the Company.

Our 2008 capital expenditures are focused on growing and developing our reserves and production on our existing Block 12 acreage. Of our total $51.6 million capital expenditure budget, approximately $51.0 million is budgeted for exploration and production activities. We plan to complete the Lloyd 1 well at the Basin Edge Unit, frac two wells, work-over two wells and drill one new well in the Tarabani unit, and perform several work-over's and drill new ultra shallow wells in the Mirzaani Field Area Shallow Production Unit.

Cash Flow Activity

Operating Activities. Cash flows used in operating activities increased $1.1 million to $3.6 million for the three months ended March 31, 2008 from $2.5 million for the three months ended March 31, 2007. The increase was primarily attributable to no oil sale being completed in Q1 2008 as compared to a $1.3 million sale in Q1 2007.

Investing Activities. Cash flows used in investing activities decreased to $0.1 million in the three month period ended March 31, 2008 from $1.0 million in the 2007 period. The decrease was primarily attributable to a $13.0 million redemption (redeemed at par) of auction rate securities in 2008 compared with a $1.2 million redemption in short term investments for the 2007 period. This was partially offset by a $12.7 million increase in capital expenditures for the three months ended March 31, 2008 as compared to 2007. Increased capital expenditures related mainly to drilling on the Basin Edge project in Q1 2008 whereas the drilling program had not yet ramped up in Q1 2007.

Financing Activities. Since March 2005, we have used equity issuances and borrowings to fund our exploration and production costs and general corporate overhead. During the three months ended March 31, 2008, $5.1 million of restricted cash was released as per the terms of our convertible debt agreement, when our stock price met or exceeded pre-determined price targets. At March 31, 2008 approximately $5.1 million of the convertible debt proceeds remains restricted as to use by the terms of the convertible debt agreements discussed at Note 6 in the attached condensed consolidated financial statements. We used the net proceeds from the restricted cash release to fund our capital expenditure programs and for general corporate purposes. Our financing activities provided $5.1 million in cash for the three month period ended March 31, 2008 compared to net used of $0.1 million in the comparable period in 2007.

Contractual Obligations and Commitments

The following table outlines our contractual obligations and commitments by payment due dates as of March 31, 2008 (in millions):

	Payments Due by Period				
	Total	Less than 1 Year	2-3 Years	4-5 Years	After 5 Years
Contractual Obligations and Commitments					
Long-term debt–principal	$ 70.2	$ -	$ -	$ 70.2	$ -
Long-term debt–interest	28.9	7.0	14.0	7.9	-
Lease agreements	1.3	0.6	0.5	0.2	-
Total contractual obligations and commitments	$ 100.4	$ 7.6	$ 14.5	$ 78.3	$ -

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make assumptions and prepare estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and revenues and expenses. We base our estimates on historical experience and various other assumptions that we believe are reasonable; however, actual results may differ. See Notes 1 and 2 ("Nature of Operations" and "Summary of Significant Accounting Policies") to our 2007 consolidated financial statements for a discussion of our significant accounting policies.

Risk Factors

Risks Related to the Natural Gas and Oil Industry and Our Business

Natural gas and oil prices are volatile, and a decline in natural gas and oil prices can significantly affect our financial results and impede our growth.

Our revenue, profitability and cash flow depend upon the prices and demand for natural gas and oil. The markets for these commodities are very volatile. Even relatively modest drops in prices can significantly affect our financial results and impede our growth. Changes in natural gas and oil prices have a significant impact on the value of our reserves and on our cash flow. Prices for natural gas and oil may fluctuate widely in response to relatively minor changes in the supply of and demand for natural gas and oil and a variety of additional factors that are beyond our control, such as:

- the domestic and foreign supply of natural gas and oil;
- the price of foreign imports;
- worldwide economic conditions;
- political and economic conditions in oil producing countries;
- the ability of members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;
- the level of consumer product demand;
- weather conditions;
- technological advances affecting energy consumption;
- availability of pipeline infrastructure, treating, transportation and refining capacity;
- domestic and foreign governmental regulations and taxes;
- the price and availability of alternative fuels;
- the inability to obtain financing on satisfactory terms.

Lower oil and natural gas prices may not only decrease our revenues on a per share basis, but also may reduce the amount of oil and natural gas that we can produce economically. This may result in our having to make substantial downward adjustments to our estimated proved reserves.

Our estimated reserves are based on many assumptions that may turn out to be inaccurate. Any significant inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

The present value of future net cash flows from our proved reserves will not necessarily be the same as the current market value of our estimated natural gas and oil reserves.

Unless we replace our natural gas and oil reserves, our reserves and production will decline, which would adversely affect our business, financial condition and results of operations.

Our potential drilling location inventories are scheduled over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.

We will not know conclusively prior to drilling whether natural gas or oil will be present in sufficient quantities to be economically viable.

Our use of 2-D and 3-D seismic data is subject to interpretation and may not accurately identify the presence of natural gas and oil, which could adversely affect the results of our drilling operations.

Market conditions or operational impediments may hinder our access to natural gas and oil markets or delay our production.

Our development and exploration operations require substantial capital and we may be unable to obtain needed capital or financing on satisfactory terms.

We have a substantial amount of indebtedness, which may adversely affect our cash flow and our ability to operate our business.

Competition in the natural gas and oil industry is intense, which may adversely affect our ability to succeed.

Our operations expose us to potentially substantial costs and liabilities with respect to environmental, health and safety matters.

The inability of one or more of our customers to meet their obligations may adversely affect our financial results.

Our development and exploration operations require substantial capital and we may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of properties and a decline in our natural gas and oil reserves.

Foreign Operations

Frontera's future revenues depend on operating results from its operations in the Republic of Georgia. The success of Frontera's operations is subject to various contingencies beyond management control. These contingencies include general and regional economic conditions, prices for crude oil, competition and changes in regulation. Frontera is subject to various additional political and economic uncertainties in Georgia which could include restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

Cautionary Statement Concerning Forward-Looking Statements

Various statements contained in this management's discussion and analysis (MD&A), including those that express a belief, expectation, or intention, as well as those that are not statements of historical fact, are forward-looking statements. The forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future production, revenues, income and capital spending. Our forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "potential," "could," "may," "foresee," "plan," "goal" or other words that convey the uncertainty of future events or outcomes. The forward-looking statements in this MD&A speak only as of the date of this MD&A; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties relating to, among other matters, the risks discussed under the heading "Risk Factors" and the following:

- the volatility of natural gas and oil prices;
- discovery, estimation, development and replacement of natural gas and oil reserves;
- cash flow and liquidity;

- financial position;
- business strategy;
- amount, nature and timing of capital expenditures, including future development costs;
- availability and terms of capital;
- timing and amount of future production of natural gas and oil;
- availability of drilling and production equipment;
- availability of oil field labor;
- operating costs and other expenses;
- prospect development and property acquisitions;
- availability of pipeline infrastructure to transport natural gas production;
- marketing of natural gas and oil;
- competition in the natural gas and oil industry;
- governmental regulation and taxation of the natural gas and oil industry; and
- developments in oil-producing and natural gas-producing countries.